

# **AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE WESTERN CAPE PROVINCIAL PARLIAMENT AND THE COUNCIL ON THE FINANCIAL STATEMENTS OF OUDTSHOORN MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2010**

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I have audited the accompanying financial statements of the Oudtshoorn Municipality, which comprise the statement of financial position as at 30 June 2010, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information, as set out on pages 3 to 54.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and in the manner required by the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2009 (Act No. 12 of 2009) (DoRA). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### **Auditor-General's responsibility**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the

appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

6. Paragraph 11 et seq. of the SA Standards of GRAP, *GRAP 1*, Presentation of Financial Statements requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by the municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.
7. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

### **Basis for qualified opinion**

#### **Accumulated Surplus**

8. The municipality records did not permit the application of alternative procedures regarding the accumulated surplus corresponding balance of R161 995 273. Sufficient appropriate audit evidence was not submitted for audit purposes relating to items of revenue and expenditure. Consequently, I did not obtain sufficient appropriate audit evidence considered necessary to satisfy myself to the existence, completeness and valuation of accumulated surplus balance of R154 135 118 (2009: R161 995 273). My audit report on the financial statements as of, and for the year ended 30 June 2009 was modified accordingly.

#### **Employee related costs**

9. There was no system of control over employee costs on which I could rely for the purpose of my audit, and there were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all employee costs were properly recorded. Consequently I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence and completeness of employee costs of R94 256 938 (2009: R80 850 030).

#### **Employee benefits**

10. There was no system of control over employee costs on which I could rely for the purpose of my audit, and there were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all employee benefits relating to employee leave benefits and long service awards were properly recorded. Consequently I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the existence and valuation of employee benefits of R7 813 056 (2009: R6 434 821).

#### **Taxes**

11. There was no system of control over Value Added Tax (VAT) on which I could rely for the purpose of my audit, and there were no satisfactory alternative audit procedures that

I could perform to obtain reasonable assurance that all VAT were properly recorded. Consequently I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the existence, valuation and obligation of VAT of R22 743 (2009: R4 810 870).

#### **Agency services income**

12. There was no system of control over income earned from agency functions on which I could rely for the purpose of my audit, and there were no satisfactory audit procedures that I could perform to obtain reasonable assurance that all income earned from agency functions was properly recorded. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness and occurrence of income earned from agency functions of R3 608 123 (2009: R3 144 429).

#### **Irregular expenditure**

13. There was no system of control over the identification and recording of irregular expenditure, as reflected in note 39.3 to the financial statements, on which I could rely for the purpose of my audit, and there were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all irregular expenditure that was incurred was properly recorded. Consequently I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of irregular expenditure.

#### **Qualified opinion**

14. In my opinion, except for the possible effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Oudtshoorn Municipality as at 30 June 2010 and its financial performance and cash flows for the year then ended, in accordance with Standards of GRAP and in the manner required by the MFMA and DoRA.

#### **Emphasis of matters**

15. I draw attention to the matters below. My opinion is not modified in respect of these matters.

#### **Unauthorised expenditure**

16. As disclosed in note 39.1 to the financial statements, unauthorised expenditure totalling R9 181 875 was incurred as a result of exceeding the approved budgeted expenditure for four votes. The operational budget was exceeded by R8 172 736 for the votes: executive and council, road transport and the Klein Karoo water scheme as reflected in note 38.2 to the financial statements. The capital expenditure budget was exceeded by R1 009 139 for votes: executive and council and finance and administration as reflected in note 38.3 to the financial statements.

#### **Fruitless and wasteful expenditure**

17. As disclosed in note 39.2 to the financial statements, fruitless and wasteful expenditure

totalling R1 517 474 was incurred due to interest and penalties as well as duplicate payments being incurred.

### **Material Losses**

18. As disclosed in note 39.4 to the financial statements, water reticulation losses occurred during the year. The extent of the losses is estimated at 1,184 mega litres (19.75%) as a result of distribution to the end users. This is considered a material loss in accordance with section 125 (2)(d)(i) of the MFMA.

### **Contingent liability**

19. A claim was lodged by the present municipal manager for back pay relating to a process of unfair suspension. The claim totalling R1 500 000 as disclosed in the note 47 to the financial statements, was initially approved by Council on 4 August 2010 but was subsequently suspended due to a court interdict. At the date of this report this matter has not been finalised.

### **Restatement of corresponding figures**

20. As disclosed in note 33 to the financial statements, the corresponding figures for 30 June 2009 have been restated as a result of errors discovered during 30 June 2010 in the financial statements of the Oudtshoorn municipality at, and for the year ended, 30 June 2009.

### **Material under spending of capital expenditure**

21. As disclosed in note 38.3, the municipality has materially underspent the budget on capital expenditure totalling R7 464 014 (17.44%). The significant underspending, relates to projects being delayed for the following votes: sport and recreation, road transport and water. As a consequence, the municipality has not achieved its objectives of adequate service delivery at the targeted level.

### **Additional matters**

22. I draw attention to the matter below. My opinion is not modified in respect of this matter.

### **Unaudited supplementary schedules**

23. The supplementary information set out on pages 55 to 65 does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

As required by the PAA and in terms of *General Notice 1570 of 2009*, issued in *Government Gazette No. 32758 of 27 November 2009* I include below my findings on the report on predetermined objectives, compliance with the MFMA, Supply Chain Management Regulations and DoRA and financial management (internal control).

### **Predetermined objectives**

#### **Non-compliance with regulatory and reporting requirements**

##### **No reporting against pre-determined objectives, indicators and targets**

24. The performance report for the financial year under review was not prepared as required by section 46 of the Municipal Systems Act, 2000 (Act no. 32 of 2000)(MSA) read with section 121(3)(c) of the MFMA.

##### **Lack of adoption or implementation of a performance management system**

25. The municipality did not adopt and implement a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players as required by section 38, 39, 40 and 41 of the MSA read with regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

### **Compliance with laws and regulations**

#### **Non-adherence**

##### **MFMA**

26. The accounting officer did not submit the financial statements for auditing within two months after the end of the financial year as required by section 126(1)(a) of the MFMA. The financial statements were received for audit purposes on 19 January 2011, seven months after the financial year-end. The above resulted in the municipality contravening section 127(2) of the MFMA, where the annual report reflecting the financial statements was not presented to Council seven months after the financial year-end.
27. Contrary to section 46(2) of the MFMA, 57 assets were leased in terms of a finance lease constituting long-term debts, without the resolution of Council.
28. Formal risk assessments were not undertaken on a regular basis and a fraud prevention plan was not implemented, contrary to section 62(1)(c)(i) of the MFMA.
29. The annual report in which the municipality should evaluate its performance in respect of programs funded by a Schedule 4 of the DoRA allocation was not prepared in accordance with the requirements of section 121 of the MFMA.

### **Division of Revenue Act, 2009 (DORA)**

30. An infrastructure performance framework was not submitted before 1 July 2009 to the National Treasury and to the transferring national officer in terms of section 15 of the Division of Revenue Act.
31. The receiving officer did not, within 2 months after the end of the financial year, evaluate its performance in respect of programs funded or partially funded by an allocation and did not submit it to the transferring national officer, contrary to section 11(5).

### **Supply Chain Management Regulations**

32. Contrary to section 21, 30 to 33, 47 and 48 of the supply chain management policy, the municipality was unable to provide the auditors with bidding documentation, minutes, attendance registers, declaration registers and committee reports to support the process of awarding competitive bids. Consequently, I did not obtain all the information and explanations I considered necessary to satisfy myself on the compliance with supply chain management regulations.

### **INTERNAL CONTROL**

33. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the MFMA, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported are limited to the significant deficiencies that gave rise to the basis for qualified opinion paragraphs, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

### **Leadership**

#### **Establish and communicate policies and procedures**

34. The municipality does not have documented and approved internal policies and procedures to address the process of collection, recording, processing and reporting of revenue, purchases, employee costs, pre-determined objectives and compliance to laws and regulations.

#### **Implement effective HR management**

35. The accounting officer position remained vacant for a substantial part of the financial year under review, consequently the following control activities did not occur effectively or did not occur at all:
  - Conducting a regular formal risk assessment process
  - Identifying risks relating to the achievement of financial and performance reporting objectives, as well as compliance to laws and regulations.

### **Decisive action to mitigate emerging risks, implement timely corrective measures**

- 36. Control weaknesses are not analysed and appropriate follow-up actions are not taken that address internal control deficiencies.
- 37. The implementation plan to address the findings of prior year's audit did not address the internal control deficiencies in many cases, thus similar issues as identified in the prior periods were raised.

### **Establish an IT governance framework**

- 38. The accounting officer does not ensure formal controls over the IT systems, were designed and implemented to ensure the reliability of the systems and the availability, accuracy and protection of information.

### **Financial and performance management**

#### **Quality, reliable financial statements and management information**

- 39. The chief financial officer was absent during the substantial part of the audit process, initially on lengthy sick leave and was subsequently suspended.
- 40. The finance department within the municipality was not adequately capacitated as extensive reliance was placed on the consultants to perform basic financial disciplines and produce the financial statements.
- 41. The finance unit did not adhere to basic financial controls throughout the financial year, i.e. the proper and regular filing of documentation supporting the financial statements and financial information, daily processing of transactions, monthly clearing of control accounts, monthly reconciliation of accounts and review thereof, as well as the preparation of monthly financial statements and the supporting schedules which support/analyse items in the financial records.

### **Proper record keeping and record management**

- 42. Adequate and complete supporting documentation with respect to revenue, VAT, expenditure and employee benefits and related costs was not available.

### **Governance**

#### **Proper risk management**

- 43. Appropriate risk management activities were not implemented to ensure that regular risk assessments, including consideration of IT risks and fraud prevention, are conducted and that a risk strategy to address the risks is developed and monitored.
- 44. Consequently, the internal audit plan was not based on a proper risk strategy.

## OTHER REPORTS

### Investigations

45. Multiple forensic investigations have been executed and finalised relating to personnel costs, acting allowances, deviation from supply chain management regulations and conflict of interest related matters. At the date of this report, further investigations were still work in progress towards prosecution and recovery of possible losses incurred.

*Auditor-General*

Cape Town

15 September 2011



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SOUTH AFRICA

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